one local market may impair its national or multi-regional plans.[36]

These spillover effects are heightened where, for example, CLEC entry entails common research, product development and marketing costs that must be covered by the sum of the CLEC's market-specific profits. Because these conditions hold for large scale CLECs, RBOC discrimination in one region against such firms reduces their profitability and thus the likelihood of entry in all regions.

Discrimination practiced by one RBOC in one market therefore creates anticompetitive spillover benefits for other RBOCs controlling other local markets. The merger allows for this externality to become internalized, since it increases the number of local markets under the control of the merged entity. Thus, the larger the RBOC "investing" in discrimination the more fully it is able to appropriate the gains from its "investment." In doing so, the merger increases the rewards of discrimination and thus makes it more certain to be practiced.[37]

The seminal Supreme Court case on monopoly leveraging fifty years ago specifically alluded to the dangers of increasing the

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36 The Application itself insists that the minimum efficient scale for local entry is extraordinary. While Sprint does not subscribe to the conclusions that SBC and Ameritech have drawn, it does agree that scale entry is important for viable entry. See also *Bell Atlantic-NYNEX,* at ¶¶ 82-88.

37 Further, signals sent in one market "educate" in other markets as well. See III Areeda & Hovenkamp, Antitrust Law ¶ 727g (1996).

number of local monopolies held by a firm bent on leveraging its power:

> A man with a monopoly of theaters in any one town commands the entrance for all films into that area. If he uses that strategic position to acquire exclusive privileges in a town where he has competitors, he is employing his monopoly power as a trade weapon against his competitors. It may be a feeble, ineffective weapon where he has only one closed or monopoly town. But as those towns increase in number throughout a region, his monopoly power in them may be used with crushing effect on competitors in other places.

United States v. Griffith, 334 U.S. 100, 107 (1948) (Douglas, J.)(emphasis added).

B. Anticompetitive Effects on Interexchange Markets

A very similar analysis yields the conclusion that the merger would also produce anticompetitive effects in long distance markets once these companies gain Section 271 authority. Again, as Drs. Katz and Salop demonstrate, the incentive and ability to discriminate in the provision of access to IXCs exist pre-merger, and they worsen with the merger.

As long as SBC and Ameritech succeed in maintaining their dominance in their local markets, "they have the power to technically discriminate in favor of their own competitive long-distance operations." Affidavit of Dale N. Hatfield, Ex.H to Comments of MCI Communications Corp. (filed in FCC CC Dkt. No. 97-137, Application of Ameritech Michigan Pursuant to Section 271 to Provide In-region, InterLATA services in Michigan)("Hatfield Aff."). Mr. Hatfield, now Chief, Office of Engineering and Technology, has explained that recent developments in local networks have in fact increased the risk of technical discrimination. The development and deployment of intelligent (software driven) networks, in conjunction with the demand for multimedia applications, materially changes the environment from the traditional, standardized voice and data interconnections to a substantially more dynamic and changing environment in which individual customers and carriers can be given customized arrangements to enable either more efficient use of traditional services and/or new services. This complexity, while making new services possible, also gives the RBOCs new opportunities to favor their own operations.

The merger would exacerbate this ability to discriminate. With the merger, the amount of traffic that would originate and terminate in-region, i.e., in the considerably increased region of the new SBC-Ameritech, would substantially increase. Sprint estimates that the new firm would terminate 45% of minutes that it controls on the originating end. This represents a substantial increase in the number of minutes Ameritech alone controls at both ends today: 30% of all minutes originating in Ameritech's territory also terminate there. Thus, Ameritech would increase the number of minutes it controls at both ends by 50%, from 30% to 45%.

The fact that considerably more traffic will become 'in-region' for both ends of the call means that the merged RBOC can raise its long distance rivals' costs at both ends of more calls. The merger also increases the incentives to discriminate because the merged entity is able to secure a larger share of the benefits of discrimination than either RBOC can secure separately. The merger, by internalizing the payoff (the anticompetitive spillover benefits), makes discrimination more profitable and thus more likely.

C. Anticompetitive Effects on New Services

Again, a comparable analysis holds for new services and/or combinations of services. The Commission must fully consider the ways in which these new service providers (or combined service providers, or "CSCs") are put at risk by the increased incentives and opportunities for discrimination: service innovation is a stated priority of this Commission.[38] As discussed above, technical advancements to local exchange networks make possible and desirable customized access and interconnection arrangements. Competitors' needs to acquire ILEC inputs in nontraditional forms or in new price configurations gives the ILECs an improved opportunity for denial and delay notwithstanding the most vigilant regulatory oversight.

As carriers search for new, innovative ways to exploit technology to give customers service improvements, they will require access to new and additional capabilities in the local exchange network. In Sprint's case, there is no better example of this than Sprint ION, or Integrated On-Demand Network. In order to bring this new and desired set of services fully to

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38 See Inquiry Concerning the Deployment of Advanced Telecommunications Capability, CC Docket 98-146, *Notice of Inquiry* (rel. Aug. 7, 1998); Inquiry Concerning the Deployment of Advanced Telecommunications Capability, *Notice of Proposed Rulemaking*, CC Dkt. 98-146 (rel. Aug. 7, 1998).

market, Sprint will need modifications to standard access and interconnection arrangements. See Brauer Aff. (*passim*).

And as Mr. Hatfield explained in the FCC's Michigan 271 proceeding, Ameritech and other BOCs can discriminate against competitors or potential competitors in such cases through outright refusals of appropriate interconnection arrangements or by slowrolling competitors. "The ability to refuse or delay such requests puts Ameritech in the position of controlling the development of new and competitive services, both as to whether the new service is created at all, or more subtly, when it comes to market and who can provide it." Hatfield Aff. at 21.

The combination of SBC and Ameritech would increase these RBOCs' incentives to fail to cooperate for new services like ION, because, like the effects in local and long distance, the combined entity's presence in a very large number of markets means that the rewards of discrimination in one market are more fully captured in the larger region. The mechanisms that create the spillovers here and thus the increased incentive to discriminate are discussed in full in Katz and Salop. Especially given services such as ION, which are in essence a network of services the value of which rises as more and more customers are added to the network, discrimination in one market will ripple throughout other markets. Where a service offers increased value to subscribers for on-net communications, exclusionary conduct that reduces the number of subscribers in one region reduces the value of the service in other regions. Also, reductions in incremental net revenues from discrimination suffered by a CSC in one region will reduce the overall incremental net revenues available to that CLEC, making it difficult to cover investments necessary to serve new areas. Again, the payoff to the RBOCs from exclusionary behavior is materially greater post-merger. See Katz and Salop at ¶ 34-54; Affidavit of Gene Agee, Attachment F.

As described by Drs. Katz and Salop, discrimination is more certain if the merger is allowed because of the additional problems it poses for regulators to monitor and detect misconduct. As explained in full by Drs. Farrell and Mitchell, by reducing the number of benchmarks by which performance can be measured, the merger significantly enhances the ability of all RBOCs (and GTE) to act in anticompetitive ways without successful regulatory interdiction.

D. The Commission Should Deny the Application on the Basis of These Adverse Vertical Effects.

The preceding sections demonstrate that the competitive consequences of the merger are unambiguously negative. As shown, the vertical effects in the local, long distance, and new services markets are anticompetitive because the merger increases the incentive and the ability of the firms to exploit their monopoly power over interconnection and access services necessary to the provision of those downstream services.

These consequences plainly warrant the conclusion that the merger is contrary to the public interest. The Commission has repeatedly reviewed transactions for their vertical effects, including the likelihood of increasing incentives to raise rivals' costs through price and non-price discrimination. See, e.g., Merger of MCI Communications Corp. and British Telecommunications plc, GN Dkt. No. 96-245, *Memorandum Opinion and Order,* 12 FCC Rcd 15351, 15412 (1997) ("we are concerned whether the merger...will increase the ability or the incentive of the vertically integrated firm to affect competition adversely in any downstream end-user market"); Sprint Corporation Petition for Declaratory Ruling Concerning Section 310(b)(4) and (d) and the Public Interest Requirements of the Communications Act of 1934, as amended, ISP-95-002, *Declaratory Ruling and Order,* 11 FCC Rcd 1850, at ¶¶ 58-60 (1996). In the specific context of its review of prior RBOC mergers, the Commission has expressly stated its concern not only for the market power and possible misconduct that characterize the RBOCs pre-merger, but also "the incremental increase in that power or misconduct that will result from the proposed transfer." Applications of Pacific Telesis Group and SBC Communications, For Consent to Transfer Control of Pacific Telesis Group and its Subsidiaries, Report No. LB-96-32, *Memorandum Opinion and Order,* 12 FCC Rcd 2624 at ¶ 42 (1997); see *Bell Atlantic-NYNEX,* at ¶ 120 (1997) (rejecting argument made by opponents because they had not shown how the merger would "increase applicants' incentive or ability to engage in non-price discrimination"). Here, the showing has been plainly made; both the incentive and the ability to engage in anticompetitive conduct worsen with the merger.

The Commission has plenary authority over questions of industry structure. The Commission's statutory mandate extends well beyond merely correcting bad conduct; it obligates the FCC to affirmatively act to assure efficient industry structures which themselves will aid to minimize such conduct. On numerous occasions, reviewing courts have upheld the FCC's use of its broad authority to prescribe a particular industry structure in order to achieve perceived benefits or to avoid potential problems.

The FCC's initial Computer Inquiry proceeding provides a clear example of such action. In Computer I, the FCC promulgated regulations which required common carriers to provide non-regulated data services through a structurally separate corporate entity. The Second Circuit upheld the FCC's authority to regulate common carrier entry into the unregulated field of data processing services.

> The burgeoning data processing activities of the common carriers pose, in the view of the Commission, a threat to efficient public communications services at reasonable prices and hence regulation is justified under its broad rule-making authority.[39]

In so doing, the Court rejected petitioners' attempts to narrow the FCC's authority.

> It is irrelevant that the [separation] rule is aimed at potential rather than actual domination or restraints, or that the Commission is not certain that the developments forecast will occur if the rule is not enacted.[40]

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39 GTE Service Corp. v. FCC, 474 F.2d 724, 730 (2d Cir. 1973).

40 Id. at 731 (citation omitted). In Computer II, the Commission required AT&T to provide data services through a separate subsidiary and once again the appellate court deferred to the Commission's determination of the appropriate industry structure. Computer and Communications Indus. Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied 461 U.S. 938 (1983).

The FCC's authority over the structure of the industries it regulates extends to outright proscription of certain entities participating in some markets. The FCC's cable-telephone cross-ownership rules promulgated in 1970 and eventually removed by Congress after the rules had served their purpose are a prime example of this.[41] In reviewing the agency's initial decision, the Fifth Circuit explained the Commission's broad authority under the Communications Act, specifically relying upon sections 151, 152(a) and 214.

> The Commission is obliged to discharge its responsibilities in this area as best it can and it has chosen in this instance to implement the national policy by limiting the involvement of common carriers, over which the Commission has unquestioned jurisdiction, in CATV operations. . . . Although [the FCC] *does not yet know how broadband cable services will or should develop, it is unwilling at this point to allow the telephone companies to pre-empt the field simply by virtue of their control over means. . . . [T]he elimination of this danger is consistent with the Commission's broad duties under the Communications Act.*[42]

These cases demonstrate the prophylactic nature of the FCC's powers over industries it regulates. Plainly the FCC has the authority -- indeed the obligation -- to consider transactions in light of whether they promote efficient market structures. It

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41 These rules were ultimately codified by Congress, and subject to constitutional challenges. See Chesapeake and Potomac Telephone Co. of Va. v. United States, 42 F.3d 181 (4th Cir. 1994), cert. granted 115 S.Ct. 208 (June 2, 1995), remanded (Feb. 27, 1996). The litigation was mooted by the amendments made by the Telecommunications Act of 1996.

42 General Tel. Co. of the Southwest v. FCC, 449 F.2d 846, 854-857 (5th Cir. 1971) (emphasis added) (citation omitted).

need not and must not acquiesce in proposals that force it to await the inevitable inefficient outcomes and search for second-best, after-the-fact remedies.

IV. The Merger Will Diminish the Effectiveness of Regulation by Reducing the Number of Available Benchmarks

The declining number of large incumbent LECs will adversely affect the FCC's:

> ability to carry out properly its responsibilities to ensure just and reasonable rates, to constrain market power in the absence of competition, and to ensure the fair development of competition that can lead to deregulation.... As diversity among carriers declines, both this Commission and state commissions may lose the ability to compare performance between similar carriers that have made different management or strategic choices. Because we approve this merger with conditions, thereby reducing the number of independently controlled large incumbent LECs, future applicants bear an additional burden in establishing that a proposed merge will, on balance be pro-competitive and therefor serve the public interest, convenience and necessity.

Bell Atlantic-NYNEX, at ¶ 16. These recent Commission observations have a long tradition -- one stemming from the divestiture and formation of seven RBOCs. As the Court of Appeals for the D.C. Circuit noted:

> There is a lot of evidence that the break-up and other recent developments have enhanced regulatory capability.... [T]he existence of seven [R]BOCs increases the number of benchmarks that can be used by regulators to detect discriminatory pricing.... Indeed, federal and state regulators have in fact used such benchmarks in evaluating compliance with equal access requirements ... and in comparing installation and maintenance practices for customer premises equipment.

United States v. Western Electric Co., 993 F.2d 1572, 1580 (D.C. Cir.), cert. denied 510 U.S. 984 (1993).

The regulatory utility of benchmarks has only increased over this period, as explicated in detail in the attached paper of Drs. Joseph Farrell and Bridger Mitchell, "Benchmarking and the Effects of ILEC Mergers." As they explain, benchmarking is a very valuable tool. The Commission's regulatory responsibilities require it to reach complex decisions regarding the pricing of monopoly services or inputs (e.g., interstate access) and the quality of access or interconnection with such services and inputs (e.g., access to UNEs). The FCC's ability to confidently assess proposals by regulated monopolies is greatly impaired by the unambiguous asymmetry in information between the regulator and the regulated firms.[43] As explained more fully by Drs. Farrell and Mitchell, benchmark regulation has been used in material ways to ameliorate this fundamental problem. It can also help to diminish the perverse incentives created by regulation itself (the "ratchet effect").

Currently, the Commission's statutory tasks are substantially facilitated by its ability to compare one RBOC's costs and other measures of performance with those of other RBOCs and GTE. The merger will impair the Commission's benchmarking ability and therefore its ability to successfully implement the Act by further reducing the already small number of RBOCs whose

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43 United States v. Western Elec. Co., 900 F.2d 283, 302 (D.C. Cir. 1990) (citing to DOJ for proposition that the risk of cross-subsidization is "significantly mitigate[d]" by FCC regulation -- "especially the availability of benchmarks to enforce effective accounting rules") (citation omitted).

performance can be used to gauge the performance of any particular RBOC (or GTE).

For example, in discussing the use of Automated Reporting Management Information System ("ARMIS") report data to compare service quality and infrastructure data across price cap ILECs, the FCC recited:

> From the inception of the monitoring program, benchmarking has been a primary goal.... [B]enchmarking promotes the Commission's uniform reporting goals and is indispensable in monitoring the impact of price cap regulation on ILEC service quality and infrastructure development.... '[t]he benefit of benchmarking in price cap ILEC monitoring is that the benchmark is as dynamic as the telecommunications industry.'

Quality of Service Standards in LEC Tariffs, CC Dkt. No. 87-313, *Memorandum Opinion & Order*, 12 FCC Rcd 8115 at ¶ 57 (1997) (citations omitted).

The plurality of approaches among large ILECs has been central to the FCC's development of regulations to implement interconnection rules under sections 251 and 252 of the Act. The process by which the Commission established standards for local number portability provides a prime example. While all other major ILECs claimed that the Location Routing Number (LRN) method of implementing local number portability would not be economically feasible,[44] Ameritech conceded the feasibility of

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44 Telephone Number Portability, CC Dkt. No. 95-116, *First Order on Reconsideration* at ¶ 34 (rel. Mar. 6, 1997). The other ILECs had advocated query-on-release. This method would have resulted in lower-quality service on calls to telephone numbers ported to competing local carriers and thus help ILECs to exclude rivals from local service markets.

LRN. The Commission imposed the competitively superior LRN alternative.[45] As Drs. Farrell and Mitchell observe, if Ameritech had joined the other large ILECs in claiming that LRN was impracticable, "it seems unlikely that the Commission would have had the knowledge or confidence to require it, or to do so on the same timetable." Farrell and Mitchell at 15.

The Commission explained in *Bell Atlantic-NYNEX* that the existence of numerous large ILECs allows for differences to arise among the carriers; this results in faster solutions to issues and problems, thereby accelerating competition.[46] For instance, on any particular issue, one ILEC may have different incentives than another; however, when ILECs merge, incentives are aligned to protect the post-merged entity's overall interests.[47] "This may result in the post-merger incumbent LEC cooperating less than the pre-merger incumbent LECs would have in enabling competition to grow."[48] In addition, the remaining comparisons become less meaningful as the disparity in sizes among the RBOCs increases. Once the disparity in size is considered (relevant to some but

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45 Id. at ¶¶ 13, 38.

46 *Bell Atlantic-NYNEX*, at ¶ 154. See also Peter Huber, *The Geodesic Network: 1987 Report on Competition in the Telephone Industry at 3.24, 3.54*-3.55 ("Benchmarking one LEC's performance against another in the post-divestiture marketplace has proved an effective regulatory tool. Laggard or eccentric LEC performance stands out when eight large holding companies line up for periodic regulatory inspection").

47 *Bell Atlantic-NYNEX*, at ¶ 154.

48 Id., at ¶ 154.

not all issues), the number of reliable benchmarks becomes effectively even smaller.

Indeed, it was none other than Ameritech -- party to this application -- that filed a lengthy submission with the federal district court in 1987 cataloguing dozens of instances in which the FCC, the Justice Department, and the private sector have successfully compared one RBOC performance against another to the benefit of public policy.[49] Yet now, Ameritech would have the Commission discard this evidence.

The impairment of regulatory effectiveness through the loss of benchmarks is squarely part of the public interest analysis necessary to the application's evaluation. Congress intended for the 1996 Act to promote competition, leading to the deregulation of the telecommunications markets.[50] In light of these goals, the Commission requires applicants to demonstrate that their proposed mergers will affirmatively promote the public interest in both competition and deregulation.[51]

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49 See "Benchmark Comparisons," Attachment A to Ameritech's Comments on the Report and Recommendations of the United States Concerning the Line-of-Business Restrictions (Western Elec. Co.), 1987 D.C. Cir. Civ. Action No. 82-0192 (filed Mar. 13, 1987) (attached to Attachment C).

50 Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 104-230, at 1 (1996); see also *Bell Atlantic-NYNEX*, at ¶ 145 ("Increased market power would be fundamentally inconsistent with the primary policy goal of the 1996 Act -- the development of competition in, and the deregulation of, telecommunications markets.").

51 Applications of Teleport Communications Group Inc., and AT&T Corp. for Consent to Transfer of Control of Corporations Holding Point-to-Point Microwave Licenses and Authorizations to Provide International Facilities-Based an Resold Communications Services, *Memorandum Opinion and Order*, CC

Of course, the two goals are related. Actions and industry structure that are procompetitive will generally improve the ability of regulators to move toward deregulation; anticompetitive steps and structure will for the most part increase the need for regulation. This relationship works in the other direction as well; as regulatory effectiveness diminishes, anticompetitive actions by regulated firms are more likely to occur.

As explicated in full by Drs. Farrell and Mitchell, as well as by Drs. Katz and Salop, the decrease in benchmarks will predictably improve RBOCs' ability to discriminate. The merger would thus make it less likely that "best practice" benchmarking will reveal as desirable an outcome, and would increase the zone of tolerance when scrutinizing "worst practices." These effects would thwart competition and injure consumers. On this basis alone, the reduction in benchmarks dictates the conclusion that the merger is contrary to the public interest.

The Commission stated in *Bell Atlantic-NYNEX* that,

> [u]ntil competition develops sufficiently to erode market power and permit deregulation, we will be concerned with the impact of proposed mergers on the effectiveness of this Commission's and state commissions' ability to constrain market power and ensure fair rules for competition. A reduction in the number of separately owned firms engaged in similar businesses will likely reduce this Commission's ability to identify, and therefore, to contain, market power.[52]

Dkt. No. 98-24 at ¶ 12 (1998)("Teleport/AT&T"); see also *Bell Atlantic-NYNEX*, at ¶ 2.

52 *Bell Atlantic-NYNEX*, at ¶ 147. Moreover, the Commission has recognized that without competition, deregulation cannot be accomplished without risking monopoly prices for consumers. See In re Application of Ameritech Michigan Pursuant to

Consequently, the Commission's regulation will be less effective in promoting the arrival of competition in the SBC and Ameritech areas.[53]

The industry structure that would result from this merger, particularly in tandem with the announced Bell Atlantic-GTE merger, would be dramatically different from that considered one year ago in *Bell Atlantic-NYNEX*.[54] At that time, the Commission stated that "further reductions in the number of Bell Companies or comparable incumbent LECs would present serious public interest concerns."[55] As demonstrated above, the merger of SBC and Ameritech raises critical issues regarding the ability of the Commission and state regulators to effectively regulate SBC post-merger. In light of the BA-GTE proposed merger as well as others since the Bell Atlantic consolidation, even fewer benchmarks will

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Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services In Michigan, CC Dkt. No. 97-137, *Memorandum Opinion and Order*, 12 FCC Rcd 20543 at ¶ 19 (1997).

53 General Tel. Co. of the Southwest v. United States, 449 F.2d 846 (5th Cir. 1971) ("It is settled that practices which present realistic dangers of competitive restraint are a proper consideration for the Commission in determining the 'public interest, convenience, and necessity,' . . . and the elimination of this danger is consistent with the Commission's broad duties under the Communications Act.")(citations omitted); In re Cease and Desist Order Directed Against Video Enterprises, Inc., Holyoke and South Hadley, Mass., 52 FCC 2d 630, 637 (1975) (denying the Commission its right to determine what is in the public interest is inimical to sound effective regulation).

54 See *Bell Atlantic-NYNEX*, at ¶ 155.

55 Id. at ¶ 156.

be available for the Commission and state regulators to restrain SBC's market power. The Commission must take into account these proposed mergers and the number of benchmarks that will remain should these mergers be consummated.

Even if one sets aside the anticompetitive consequences of the loss of benchmarks, the costs of alternative forms of regulation that the Commission would be forced to use in the wake of diminished benchmarks would independently compel the conclusion that the merger is contrary to the public interest. In order to fulfill its regulatory duties, the Commission would have to insist on more intrusive and much costlier regulatory oversight of large ILECs. Absent benchmarking, the Commission would have to investigate directly and at substantial cost the actual motivations and/or results of challenged conduct.

More direct measures to assess the reasonableness of BOC conduct or positions would need to be implemented. Tools such as increased audits, use of document and *in personae* subpoenas to examine internal decisionmaking, and a vastly stepped-up need for after-the-fact complaint adjudication are just some of the inferior alternative tools the FCC would be forced to try. Broad on-the-record hearings to discern anticompetitive conduct from legitimate defenses, reminiscent of the FCC's Docket 19129 of the Bell System, might be necessitated.

The Commission could not of course merely acquiesce in its newfound state of diminished regulatory effectiveness. Just as the Commission cannot regulate where there is no issue to address[56] and just as it must review regulations periodically to ensure that such regulations are still required,[57] so too must the Commission not fail to regulate where such action is demanded in the public interest.[58] Such a failure would be contrary to the general public interest mandates as well as the Act's specific requirements that it ensure just and reasonable rates and practices. It would also violate the 1996 Act's command that the Commission forbear from its statutory and regulatory obligations only where such forbearance "will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services."[59]

Plainly, the radically escalated need for direct regulation would be viewed with great disfavor by regulated firms but more importantly taxpayers. The increased regulatory burdens -- keeping in mind that they represent second best solutions in any event -- dictate the conclusion that the merger is contrary to the public interest.

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56 See Home Box Office v. FCC, 567 F.2d 9, 34 (D.C. Cir.), cert. denied 434 U.S. 829 (1977).

57 See Geller v. F.C.C., 610 F.2d 973 (D.C. Cir. 1979)

58 See generally Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Dkt. No. 20828, *Final Decision* 77 FCC 2d 384, 433 (1980) ("Commission regulation must be directed at protecting or promoting a statutory purpose.")

59 47 U.S.C. § 160(b).

Finally, the Commission should consider the fact that the decrease in benchmarks will affect the ability of private parties to negotiate favorable conditions with ILECs. Just as the Commission uses benchmarks as regulatory tools to keep firms with market power in check, private parties use benchmarks to compel ILECs to match each other's capabilities. As noted above, when mergers occur, incentives become aligned, and benchmarks are decreased. As a result, competitors have less opportunity to exploit the differences between the ILECs, thereby affecting the efficiency of the market and the ability of competitive firms to offer competitive services in a proficient manner.

V. The Merger Would Also Have Anticompetitive Effects in the Video Distribution Markets And Raises Substantial Questions of Lawfulness Under Section 652.

Almost as an afterthought to the application, SBC and Ameritech briefly acknowledge, without any real discussion, the presence of Ameritech in the local video distribution markets in Ohio, Illinois, and Michigan. The applicants assert summarily that "[the] merger will not adversely affect competition in the market for multichannel video programming distribution."[60] The filing further notes that "the main competitive alternatives to cable are wireless ones, *with the exception* of SNET's and Ameritech's overbuilds. . . ."[61] The applicants do not address

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60 See Description at 101. The filing notes that 87% of customers subscribing to multi-channel video systems are served by traditional cable companies. See id. at 100-101.

61 Id. at 101 (emphasis added). Compare Ameritech's statements to the Commission, in CS Dkt. No. 98-102, insisting that DBS service "fails to constrain cable price increases." Comments of Ameritech at 15, Notice Of Inquiry Annual

what plans the merged entity may have to expand or even continue this business. The applicants do not address the fact that SBC shut down PacTel's competitive video distribution business once it was allowed to acquire these assets. The applicants do not address the fact that SBC had in fact represented to the FCC that one benefit of its acquisition of Pacific Telesis would be to foster video competition.[62] And the applicants do not address how the proposed transaction can be squared with the plain language of Section 652 of the Communications Act.

Ameritech's cable service in its region is substantial. Ameritech describes its video operations as "the largest cable

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Assessment of the Status of Competition in Markets for the Delivery of Video programming, filed July 31, 1998 ("Ameritech Video Competition Report Comments").

62 See Joint Opposition of SBC and PacTel to Petitions to Deny at 37 (filed in FCC Report No. LB-96-32 Aug. 9, 1996)("SBC and Telesis were taking steps to pursue entry into the provision of video services through different means and only in different geographic areas, and consumers will benefit from the combination of those efforts. Both companies are new entrants into a field with large, entrenched firms. The proposed merger will enable the stronger merged company to benefit from each of SBC's and Telesis' accumulated expertise and will facilitate innovative and timely deployment.")(citations omitted; emphasis in original); Application of SBC and PacTel, Public Interest Statement at 12 (filed June 7, 1996) ("A key goal of the 1996 Act is to expand competition in video programming and distribution. It established multiple options for entry by telephone companies. Before the new law, SBC and Telesis each took steps to enter video services in different areas -- including SBC's cable operations in the Washington, D.C. Metropolitan Area and Richardson, Texas; Telesis' MMDS and other video authorizations in California and elsewhere; and both companies' interests in video programming ventures. The proposed merger will enable them to benefit from each other's accumulated expertise and facilitate innovative and timely deployment of video services and facilities").

overbuilder in the country."[63] According to Ameritech, it holds "franchises in 78 communities having a total population of more than 3 million people living in over one million homes." See Ameritech Video Competition Report Comments at 11. It operates cable systems in 61 communities; doubling in one year the number of its served communities. It has 150,000 cable subscribers; and reports that it has captured market share of "[o]ne out of every three cable subscribers where Ameritech is marketing...." Ameritech Video Competition Report Comments at 11.

Ameritech's cable overbuild activity has apparently been competitively significant. In its July 31, 1998 filing, Ameritech catalogued at length the competitive responses from cable operators, claiming that its innovative service has "spurred incumbent cable operators into action, causing them to modify their service and respond with their own version of improved, higher quality service offerings at more affordable prices." Ameritech Video Competition Report Comments at 11 and Attachments 1 and 2 thereto. Further, Ameritech has at the federal level been active in seeking ways to facilitate competitive video markets, including especially its successful efforts at the Commission to revise its program access complaint procedures.[64]

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63 Comments of Ameritech New Media, Inc. in MM Dkt. No. 92-264 and CS Dkt. No. 98-82, at p.1 n.1. (filed Aug. 14, 1998).

64 See Petition for Rulemaking of Ameritech New Media, Inc., Report and Order, CS Docket No. 97-248, FCC 98-189 (rel. Aug. 10, 1998).

Because Ameritech has specifically sought elsewhere to demonstrate the competitive value of its cable systems, it is imperative that the Application provide substantially more information to explain and demonstrate the effects of the merger on these video distribution markets. Especially given SBC's apparent decision to withdraw its own and PacTel's entries into these markets, it is woefully insufficient to merely state that SBC will step into the shoes of Ameritech here. Moreover, as described below, it appears that Section 652 precisely precludes SBC from so doing.

Section 652(a) of the Act prohibits local exchange carriers from acquiring more than a 10% financial interest in cable operators that provide cable service within the LEC's telephone service area.[65] Like the more restrictive cable-telephone company cross-ownership prohibition that preceded it, Congress adopted Section 652 to ensure that incumbent LECs do not utilize their monopoly power to stifle competition in the video programming market.[66] Unlike the cross-ownership statute that preceded it, however, Section 652 contains express provisions governing ILEC attempts to acquire not only the first cable

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65 47 U.S.C. § 572(a).

66 See H.R. Rep. No. 103-560 (1994) ("Concern over the telephone companies' potential to capitalize on their position as a monopoly service provider, their ability to cross subsidize illegally to finance any new cable plant, and their potential to stifle competition in the growing video and information services industry has been the thrust of the argument against telephone company entry into new lines of business.")

system in the market but any overbuild systems as well. The Commission incorporated Section 652 into its rules regarding the ownership of cable systems shortly after the passage of the Telecommunications Act of 1996.[67]

Section 652(e) defines "telephone service area" as:

> the area within which [the] carrier provided telephone exchange service as of January 1, 1993, but if any common carrier after such date transfers its telephone exchange service facilities to another common carrier, the area to which such facilities provide telephone exchange service shall be treated as part of the telephone service area of the acquiring common carrier and not of the selling common carrier.[68]

Because Ameritech is effectively transferring its facilities to SBC under the proposed merger, Section 652(e) indicates that SBC's telephone service area must include Ameritech's service area for the purposes of Section 652.

SBC is of course acquiring control of Ameritech's cable service operation as well as its telephone facilities. Because Ameritech's cable operations provide service within SBC's telephone service area as defined by Section 652(e), Section 652(a) prohibits the merger unless the acquisition falls under one of Section 652(d)'s enumerated exceptions. Information available suggests that the merger is not covered by any of the exceptions,[69] including Section 652(d)(3).

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67 See Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, CS Dkt. No. 96-85, *Order and Notice of Proposed Rulemaking*, 11 FCC Rcd 5937, 5953-56 (1996).

68 47 U.S.C. § 572(e).

69 Sections 652(d)(1) and (d)(2) apply to rural systems and joint use agreements, respectively. Because Ameritech's

Section 652(d)(3) applies to acquisitions in "competitive markets" that is, markets where more than one cable system is present.[70] The subsection provides certain specified exceptions to the general anti-buyout prohibition. For an acquisition to fall under its umbrella, Section 652(d)(3) requires that (A) the subject cable system operates in a non-top 25 television market, the market has more than one cable operator, and the subject cable system is not the system with the most subscribers in the market; (B) the subject cable system and the system with the most subscribers held franchises, with identical boundaries, from the largest municipality in the market as of May 1, 1995; (C) the subject system is not owned by any of the 50 cable systems with the most subscribers as such systems existed on May 1, 1995; and (D) the system with the most subscribers is owned by one of the 10 largest cables systems operators as such operators existed on May 1, 1995.[71] All of these requirements must be met; if they

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cable operations are not located in rural areas, and because the proposed merger goes beyond a joint-use agreement, those sections do not seem to apply. See 47 U.S.C. § 572(d)(3)(A), (4)(C). Section 652(d)(4) does not apply because it requires the cable system to be acquired to operate in a non-top 100 market. See 47 U.S.C. § 572(4)(C). Ameritech's cable service operations in Chicago, Detroit, Cleveland, and Columbus are all in top 100 markets. See 1 Broadcasting & Cable Yearbook 1998 B-234 (Reed Elsevier 1998). Section 652(d)(5) does not apply to the proposed merger because it requires the LEC's annual operating revenues to be less than $100,000,000. 47 U.S.C. § 572(d)(5).

70 See 47 U.S.C. § 572(d)(3).

71 See id.

are not all met, then the general rule against acquisition applies.

At a minimum, subsection (A) is not satisfied as it pertains to three substantial markets in Ameritech's cable service area. Chicago, Detroit, and Cleveland are all top 25 television markets.[72] Ameritech's cable systems in those markets therefore fall outside of the scope of Section 652(d)(3)'s exception. The proposed merger may fail to meet other requirements of Section 652(d)(3), but further information not readily available would be required to make such a determination. SBC and Ameritech must also demonstrate compliance for those markets not already excluded from the exception by the top 25 market requirement.

Section 652 of the Act prohibits the type of telco-cable buyout that would occur if the proposed SBC-Ameritech merger is approved. On its face, the merger does not appear to fall within any of the exceptions enumerated in Section 652. If information exists that demonstrates otherwise, the burden to produce that information must fall on SBC and Ameritech.[73] Absent such a showing (which does not appear factually possible), the transaction is unlawful under Section 652.

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72 See 1 Broadcasting & Cable Yearbook 1998 B-234 (Reed Elsevier 1998).

73 See 47 U.S.C. § 309(e) (burdens of proceeding and proof rest upon applicant). See also *Bell Atlantic-NYNEX,* at ¶ 29 and n.55 (further citations omitted).